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ANNUAL RETIREMENT GUIDE

More Dollars Later In Life

A longevity policy allows you to spend more freely in retirement

Ninety-five is the new 85. At least, in financial planning it is. With insurers expecting at least one in three baby boomers to live into their 90s, the risk of running out of money looms large. That's why a handful of insurers have recently introduced a new type of annuity, "longevity insurance."

Like a conventional annuity, this one converts a lump-sum payment into guaranteed monthly income. Such income annuities usually start issuing checks immediately, but longevity payments don't typically kick in until the policyholder turns 80 or 85. Because the insurance company has held your money for a long time, when payouts start, they're big. A 65-year-old who puts $250,000 into a longevity policy today can expect to receive as much as $210,000 a year from age 85 on. With a traditional income annuity, he'd get just $20,400 per year.

What you're really buying with such policies is the freedom to spend more. Knowing that this safety net will fall into place, you'll be able to withdraw a greater percentage of your savings earlier in retirement than would otherwise be prudent—some 7% a year, versus 4%, says Shane Chalke, CEO of Seven Squared Financial of Middleburg, Va., which is developing annuity products. Of course, the policy's payments will continue for as long as you live. That will push the effective rate of return on one issued at a competitive price today to 8% at age 90 and above 10% at 100, says Christopher Cordaro, chief investment officer at RegentAtlantic Capital, a Chatham (N.J.) wealth management firm. "This allows you to maximize consumption over your lifetime." If you put a small slice of your assets, say 10%, into such a product at age 60 or 65, you'll be able to spend about 20% more throughout retirement than if you were to rely solely on bonds or regular annuities for income, says Jason Scott, managing director of retiree research at Financial Engines, a Palo Alto (Calif.) adviser to 401(k) participants.

You may even be able to generate a fatter nest egg. That's because, with late-in-life dollars guaranteed, you may feel comfortable investing a higher portion of your portfolio in equities, which have outperformed bonds over the long run. "Planners joke that if you tell me the date of your death, I can put together a great plan for you," says Jeremy Alexander, president of Beacon Research, an Evanston (Ill.) annuity-data research company. "With this product, you can essentially do that by planning to make your assets last until these payments begin."

Longevity insurance also lessens one of the biggest problems associated with conventional annuities: the fact that, once you sign over your money, you (or your heirs) can't get it back, even if you die before collecting a dime. Assuming you want the highest payout possible, the same rules apply to longevity contracts. But because it takes far less money to secure a specific income with a longevity plan than with a regular annuity, you'll have more left over in liquid assets to defray unexpected expenses.

Currently only a handful of insurers offer these policies, all of them highly rated. Still, because the market is inchoate, obtaining quotes isn't easy: You'll have to contact agents. Make sure you're comparing annuities on an apples-to-apples basis. For example, while most defer payments until age 80 or 85, New York Life Insurance Co.'s Lifetime Income Annuity with Changing Needs Option issues modest payouts immediately that can jump as much as fivefold on a designated date the policyholder selects at the outset.

Each carrier also offers add-ons to the basic contract. These include inflation protection, a death benefit to be paid to heirs, early payments for nursing home care, and a cash withdrawal option. The downside is a smaller payout. "Every piece you add to this product waters down the benefit," says Chalke. The only extra worth taking, say experts, is inflation protection: Some carriers allow you to choose an annual raise of 1% to 5%.

When should you buy? Some recommend waiting for interest rates to rise or more competitors to enter the market, both of which will boost payouts. But the longer you wait, the more you'll pay for a given level of benefits, simply because your chances of surviving to

receive payouts improve as you age. "Buy when you retire," advises Scott. Figure out how much of your essential expenses you can cover with Social Security, pensions, and other forms of guaranteed income—and consider buying coverage for the rest.

Don't put too much into this basket. "Typically, if you allocate 10% to 15% of your portfolio to this, it will give you about two-thirds of the benefit you'd get if you were to annuitize your entire portfolio," says Scott. All told, it's a good deal, provided you live long enough to collect.

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